

Report
of the
Examination of
Wisconsin Vision Service Plan
Rancho Cordova, California
As of December 31, 2001

TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. HISTORY AND PLAN OF OPERATION	3
III. MANAGEMENT AND CONTROL	6
IV. AFFILIATED COMPANIES	8
V. FINANCIAL DATA	10
VI. SUMMARY OF EXAMINATION RESULTS	17
VII. CONCLUSION.....	24
VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS.....	25
IX. ACKNOWLEDGMENT	26



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
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Wisconsin.gov

December 19, 2002

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Honorable Connie L. O'Connell
Commissioner of Insurance
Madison, Wisconsin

Commissioner:

In accordance with your instructions, a compliance examination has been made of
the affairs and financial condition of:

Wisconsin Vision Service Plan, Inc.
Rancho Cordova, California

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Wisconsin Vision Service Plan, Inc. (the company) was conducted in 1997 as of December 31, 1996. The current examination covered the intervening period ending December 31, 2001, and included a review of such 2002 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Provider Contracts
- Territory and Plan of Operations
- Affiliated Companies
- Growth of the Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing
- Underwriting

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

Wisconsin Vision Service Plan, Inc. (hereinafter also “WVSP” or the “company”) was incorporated as a nonstock Wisconsin corporation on February 27, 1957, and commenced business on April 29, 1958. The company is now licensed as a service insurance corporation for optometric care under ch. 613, Wis. Stat. The company provides vision care on a group basis through employer health benefit plans.

WVSP is a vision plan in which indemnification or services provided are limited to eye care services. The company is a domestic, nonprofit, nonstock insurance corporation, organized pursuant to ch. 613, Wis. Stat. WVSP files the NAIC Health annual statement blank. The nature of the company’s license permits it to operate on an indemnity basis and to provide services to its enrolled participants through contracts with providers who are paid directly by the company.

Since July 1, 1989, WVSP has been an affiliate of Vision Service Plan, a California-domiciled nonstock, nonprofit corporation, formerly known as California Vision Service. By means of this agreement, Vision Service Plan (hereinafter also “VSP”) became the sole voting member, thereby acquiring complete control over the election of directors and the appointment of officers. In exchange, VSP agreed to provide the surplus necessary for the operation of the company and to comply with the requirements of the state of Wisconsin. In this way, WVSP became a member of VSP’s holding company system.

All services essential to the operation of the company, including, but not limited to, accounting, claim administration, and executive management, are provided by VSP. The company has appointed the Milwaukee law firm of Demet & Demet as its registered agent, in order to comply with the requirements of s. 181.08, Wis. Stat.

WVSP has written agreements with 262 licensed optometrists and ophthalmologists throughout the state of Wisconsin, and in towns bordering the State in Iowa and Minnesota, to provide vision care to enrollees in the employer groups with whom WVSP contracts.

The provider contracts include a hold-harmless provision for the protection of the policyholders. This provision prevents the doctor from looking to the patient for money owed for covered services, except any deductible or copayment. In the event that the company should

become unable to pay all or any part of its obligations, the doctor is not to look to the patient for such payment.

The company markets its plan through approximately 173 independent agents, as well as five employees among its in-house marketing staff. In-house marketing staff is paid salary and benefits. Independent agents receive the following commissions for placing groups with VSP:

Annual Premium	Paid By Group	Commission Paid
First	\$ 5,000	10.00%
Next	5,000	5.00
Next	10,000	3.56
Next	10,000	3.00
Next	20,000	2.31
Next	200,000	1.44
Next	250,000	0.73
Exceeding	500,000	0.35

Revenues of the company are derived from two sources, premiums associated with funding optometric benefits and fees received for the administration of self-funded plans. WVSP accepts the risk associated with funding optometric benefits, while the employer accepts the risk under a self-funded group plan. For the self-funded groups, WVSP pays the claims and is reimbursed for the cost plus an administration fee. The risk associated with self-funded plans is a limited credit risk, while insured plans involve underwriting risk. Of the 160 employer groups who offered a benefit plan from WVSP at the examination date, 20 were self-funded.

For groups that are not self-funded, WVSP uses two methods of determining the premiums to be charged to the groups. Groups with over 500 employees are individually rated, while groups with 10-499 employees are quoted pooled rates. Since the company does not issue individual policies, groups must have at least ten employees to offer vision care benefits through WVSP.

If a group has at least 500 employees, the group is individually rated based on pure premiums. Pure premiums are determined by analyzing the combined utilization of each plan and deductible offered. The claim frequency and average claim for each of the plans and deductibles are projected to determine the projected claim cost per employee. A reserve factor is added to this claim cost to obtain the pure premium. This pure premium is adjusted in accordance with factors such as effective date, contract term, group location, out-of-state employees, industry,

prior vision coverage, and commission status relating to the specific group. The company then applies their retention percentage to this adjusted percentage to obtain the final premium rate charged to the group.

For groups with less than 500 employees, the rates are determined on a “pooled” basis. WVSP has two pools divided between commercial (all businesses) or political (schools, cities, counties, etc.) employer groups. The rates are determined based on the combined utilization of the groups in the pool. Factors that are analyzed to determine if an increase is needed in a current pool rate include claim frequency, average claim cost, reserve requirement, and retention percentage. Rates vary within a pool depending on the size and the deductible plan of the group.

Financial Requirements

On February 13, 1990, the Commissioner executed an Order Modifying Minimum Permanent Surplus. Under this Order, the company is required to maintain minimum permanent surplus the greater of:

- (a) 10% of the previous 12 months’ premiums for all lines of business; or
- (b) \$200,000.

As of December 31, 2001, the company’s requirement for minimum permanent surplus was 10% of the company’s written premium of \$5,327,351, or \$532,735.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of five members. All directors are elected every three years to serve a three-year term. Officers of the company are appointed at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company system. The board members currently receive no compensation for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Richard D. Jones, O.D. Santa Roas, California	Doctor of Optometry	2003
Julia B. Edwards, O.D. DeForest, WI	Doctor of Optometry	2003
Catherine Amos, O.D. Birmingham, AL	Doctor of Optometry	2003
F. Mason Smith Mt. Pleasant, South Carolina	Doctor of Optometry	2003
Roger J. Valine Sacramento, California	President and Chief Executive Officer Vision Service Plan	2003

The company's bylaws permit, but do not require, the formation of committees by the board of directors. There are currently no board committees, nor have any been appointed during the period under examination.

Officers

The officers appointed by the board of directors and serving at the time of this examination are as follows. Officers are compensated by the company's parent, VSP. Executive personnel are among the employees supplied to the company pursuant to a written administrative and marketing agreement.

Name	Office
Roger J. Valine	President
Gary N. Brooks	Secretary
Patricia Cochran	Treasurer

The company is included as a named insured on its parent's corporate insurance coverage with insurers licensed in Wisconsin under the contracts summarized below:

Type of Coverage	Policy Limits
Financial institution bond	\$4,000,000 aggregate/single loss limit 2,000,000 single loss deductible
Directors and Officers Liability	10,000,000 each loss
Managed care liability insurance	1,000,000 per claim 2,000,000 aggregate
Pension and welfare fund liability	3,000,000 aggregate/single loss limit
Commercial general liability:	
Aggregate limit (other than Products/ completed Operations)	\$2,000,000
Products/Completed Operations Aggregate	2,000,000
Personal & Advertising Injury Limit	1,000,000
Each occurrence limit	1,000,000
Physical Damage (fire Legal)	1,000,000
Premises medical payments:	100,000
Building / Personal Property except one location	100,000,000 blanket limit
Other location	1,607,000
Business Income / rental Income except one location	10,000,000
Other location	No coverage
Umbrella and excess liability	30,000,000
Commercial Auto	
Combined single limit	1,000,000 each accident
Uninsured motorists coverage	1,000,000 each accident
Auto medical payments	5,000 per person
Managed Care Errors and Omissions Liability	1,000,000 Each Occurrence 3,000,000 Aggregate

WVSP is listed as a named insured, under VSP on all the above mentioned policies except for the Pension and welfare fund liability. This coverage is for the retirement plans and since WVSP has no employees appears appropriate.

IV. AFFILIATED COMPANIES

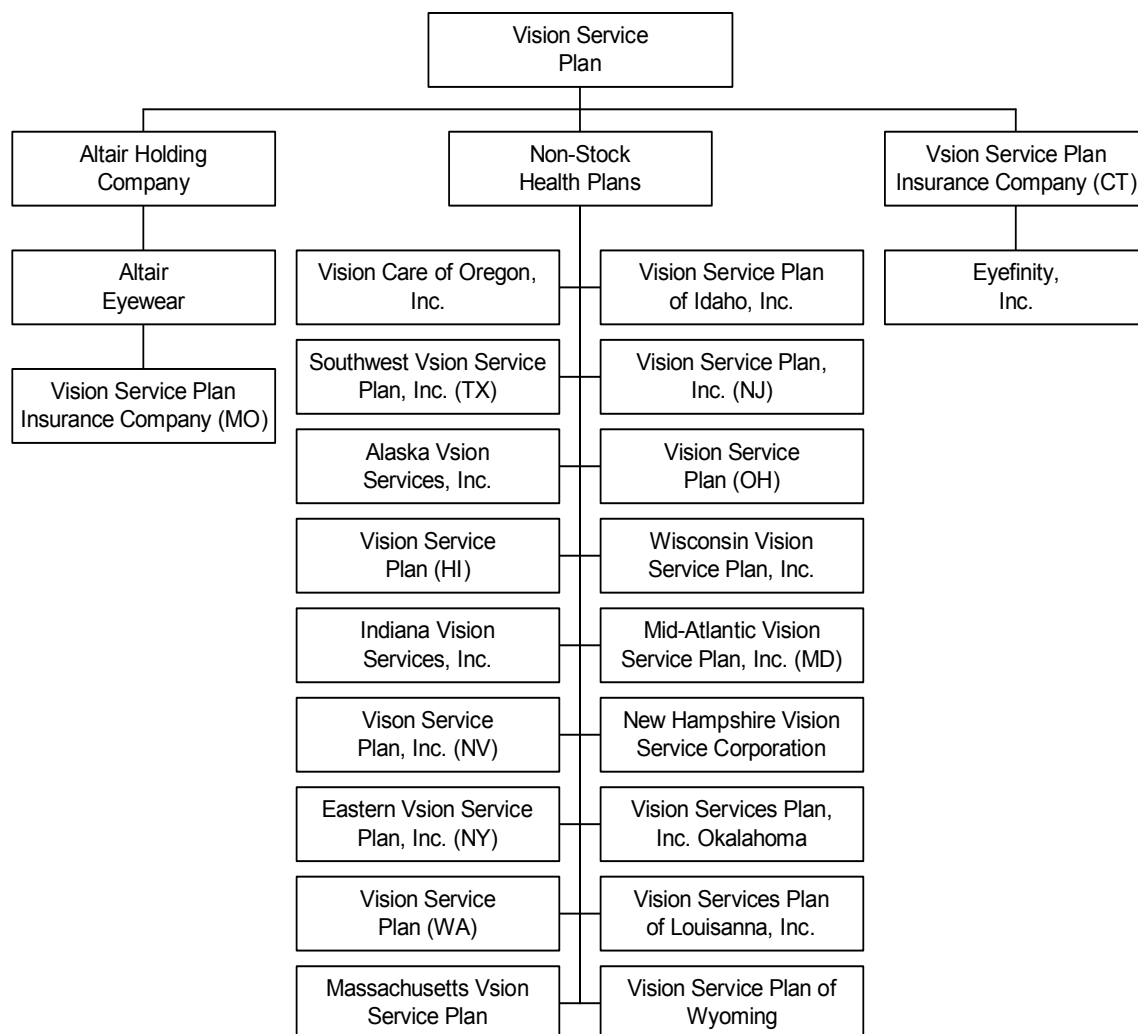
Wisconsin Vision Service Plan is a member of a holding company system. Its ultimate parent is Vision Service Plan. The organizational chart depicts the relationships among the affiliates in the group and is provided following the descriptions of the significant affiliates. A brief description of the significant affiliates of the company is described below.

Vision Service Plan

Vision Service Plan is organized as a nonprofit corporation under the laws of the State of California to provide and administer vision care plans in order to make available professional optometric services to eligible members of participating clients. VSP exercises control over 19 affiliated vision service plans, a frame distribution company and an internet services provider. As of December 31, 2001, the company's combined audited financial statement reported assets of \$669 million, liabilities of \$264 million, and capital and surplus of \$405 million. Operations for 2001 produced net income of \$113 million on total revenues of \$1.8 billion.

WVSP has no employees. Necessary staff is provided through an administration and marketing agreement with Vision Service Plan. Under the agreement, effective February 10, 1998, VSP grants WVSP nonexclusive license to use the service marks outlined in the contract, agree that their respective panel of doctors shall provide vision care services and material to patients covered by the other party's plan, and also to patients covered by other vision plans licensed by VSP known as "Reciprocal Services", provide all administrative and marketing services and expertise to operate WVSP and to market WVSP plans. VSP receives a per claim charge equal to the total general and administrative expenses of VSP and its subsidiaries. The management agreement does not specify how often VSP will be compensated. The agreement remains in effect unless terminated by either party upon sixty days prior written notice. The contract does not discuss standards of performance for VSP and a proper indemnification clause is not included. In addition, the provisions for "Reciprocal Services" as described in the agreement are no longer accurate. This is discussed further in the section of this report captioned "Summary of Examination Results."

**Holding Company Chart
As of December 31, 2001**



V. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2001, annual statement to the commissioner of insurance. Also included in this section are schedules, which reflect the growth of the company for the period under examination. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Net Worth per Examination."

Wisconsin Vision Service Plan, Inc.
Assets
As of December 31, 2001

	Assets	Nonadmitted Assets	Net Admitted Assets
Cash and short-term investments	\$2,831,277	\$ 0	\$2,831,277
Accident and health premiums due and unpaid	207,750	34,534	173,216
Investment income due and accrued	5,920	0	5,920
Amounts receivable relating to uninsured accident and health plans	<u>487,822</u>	<u>0</u>	<u>487,822</u>
Total assets	<u>\$3,532,769</u>	<u>\$34,534</u>	<u>\$3,498,235</u>

Wisconsin Vision Service Plan, Inc.
Liabilities and Net Worth
As of December 31, 2001

Claims unpaid		\$ 578,237
Unpaid claims adjustment expenses		43,160
Premiums received in advance		4,333
General expenses due or accrued		48,038
Federal and foreign income tax payable and interest thereon		510,000
Amounts due to parent, subsidiaries and affiliates		128,328
Liability for amounts held under uninsured accident and health plans		29,142
Aggregate write-ins for other liabilities (including \$(1) current)		<u>42,247</u>
Total liabilities		1,383,485
Surplus notes	\$1,450,000	
Aggregate write-ins for other than special surplus funds	534,293	
Unassigned funds (surplus)	<u>130,457</u>	
Total capital and surplus		<u>2,114,750</u>
Total liabilities, capital and surplus		<u>\$3,498,235</u>

Wisconsin Vision Service Plan, Inc.
Statement of Revenue and Expenses
For the Year 2001

Net premium income		\$5,626,374
Risk revenue		<u>57,029</u>
Total revenues		\$5,683,403
Medical and Hospital:		
Other professional services	\$5,342,928	
Claims adjustment expenses	134,443	
General administrative expenses	<u>127,000</u>	
Total underwriting deductions		<u>5,604,371</u>
Net underwriting gain or (loss)		79,032
Net investment gains or (losses)		75,679
Net gain or (loss) from agents' or premium balances charged off		<u>(3,204)</u>
Net income or (loss) before federal income taxes		151,507
Federal and foreign income taxes incurred		510,000
Net income (loss)		<u>\$ (358,493)</u>

Wisconsin Vision Service Plan, Inc.
Capital and Surplus Account
As of December 31, 2001

Capital and surplus prior reporting year		\$1,657,018
Net income or (loss)	\$(358,493)	
Change in nonadmitted assets	(33,775)	
Change in surplus notes	850,000	
Net change in capital and surplus		<u>457,732</u>
Capital and surplus end of reporting year		<u>\$2,114,750</u>

Wisconsin Vision Service Plan, Inc.
Statement of Cash Flows
As of December 31, 2001

Cash from Operations	
Premiums and revenues collected net of reinsurance	\$5,677,612
Claims and claims adjustment expenses	5,249,758
General administrative expenses paid	<u>120,769</u>
Cash from underwriting	307,085
Net investment income	87,574
Other income (expenses)	<u>(6,769)</u>
Net cash from operations	387,890
Cash from Financing and Miscellaneous Sources	
Cash provided:	
Surplus notes, capital and surplus paid in	\$850,000
Net transfers from affiliates	<u>129,168</u>
Total	979,168
Cash applied:	
Other applications	<u>387,039</u>
Net cash from financing and miscellaneous sources	<u>592,129</u>
Net change in cash and short-term investments	980,019
Cash and short-term investments:	
Beginning of year	<u>1,851,258</u>
End of year	<u><u>\$2,831,277</u></u>

Growth of the Company

The following schedules reflect the growth of the company during the examination period:

Year	Assets	Liabilities	Capital and Surplus	Premium Earned	Medical Expenses Incurred	Net Income
2001	\$3,498,235	\$1,383,485	\$2,114,750	\$5,683,403	\$5,342,928	\$151,507
2000	2,256,729	599,711	1,657,018	5,327,351	4,193,293	908,138
1999	1,912,729	715,972	1,196,757	4,299,989	3,318,225	833,549
1998	1,543,883	1,202,964	340,919	3,157,300	2,808,386	104,845
1997	1,436,860	980,179	456,681	2,547,218	2,234,044	602,906

Year	Profit Margin	Medical Expense Ratio	Administrative Expense Ratio	Change in Enrollment
2001	2.7%	94.0%	4.6%	2.6%
2000	17.0%	78.7%	5.8%	265.3%
1999	19.4%	77.2%	4.1%	83.7%
1998	3.3%	88.9%	8.4%	11.7%
1997	23.7%	87.7%	-10.8%	149.8%

Enrollment and Utilization

Year	Enrollment
2001	328,509
2000	320,027
1999	87,602
1998	47,686
1997	42,674

Per Member Per Month Information

	2001	2000	Percentage Change
Premium	<u>\$1.44</u>	<u>\$1.88</u>	-30.1%
Expenses:			
Other professional services	\$1.38	\$1.48	-7.9%
Claims adjustment expenses	0.03	0.06	-60.3%
General administrative expenses	<u>0.03</u>	<u>0.05</u>	-65.2%
Total underwriting deductions	<u>\$1.44</u>	<u>\$1.59</u>	-10.4%

The company's medical expense ratio increased significantly in 2001 from prior years. This was primarily from the company lowering rates to remain competitive, which can be illustrated in the per member per month information above.

The company reports a large increase in enrollment from 1999 to 2000. This was due to the company entering into the reinsurance agreement with United Wisconsin Life Insurance Company (UWLIC) on June 1, 1999. Under this reinsurance agreement the company assumes UWLIC's liabilities for vision care benefits under its group health insurance products. This agreement and the reporting of premiums and enrollment are further discussed in the section of this report entitled "Summary of Examination Results."

The company has accrued a tax liability of \$510,000, pending the outcome of the Internal Revenue Services (IRS) tax audit. The IRS is contesting that the company is a taxable entity based on issues raised regarding unrelated business income. The company's parent, Vision Service Plan was formally notified on October 22, 2002 that the IRS had revoked its tax-exempt status, effective prospectively only as of the tax year beginning January 1, 2003. During 2003, the IRS is expected to prospectively revoke the tax-exempt status of the remaining exempt affiliates, including the company. The company will continue to vigorously defend its tax-exempt status. The liability is no longer on the 2002 annual statement due to the fact this was set up in the case they would have to pay back taxes. When the IRS revoked the tax exempt status effective January 1, 2003 for Vision Service Plan, the company determined that the IRS would do the same for the other companies in the holding company, therefore there would be no back taxes owed.

Reconciliation of Net Worth per Examination

There were no adjustments to surplus as a result of the examination. The examination did result in one reclassification as illustrated below:

Examination Reclassifications

	Debit	Credit
Short-term Investments		\$(1,379,954)
Cash	<u>\$1,379,954</u>	<u> </u>
Total reclassifications	<u>\$1,379,954</u>	<u>\$(1,379,954)</u>

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were nine specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Biographical Data—It is again recommended that the company report biographical data relating to company officers and directors in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

Action—Noncompliance, see comments in Summary of Current Examination Results.

2. Management and Control—It is recommended that the company either observe the requirements of article IV, section 1, of its articles of incorporation, and article V, section 1, of the bylaws, concerning the duration of director terms, or amend these provisions to reflect intended practices.

Action—Noncompliance, see comments in Summary of Current Examination Results.

3. Agency Contracts—It is again recommended that the company execute formal written agreements with all agents to include language indicating the obligation of each agent to represent the company's interests in good faith.

Action—Compliance.

4. Agency Appointments—It is recommended that the company report its agent appointments to OCI pursuant to s. 628.11, Wis. Stat., and s. Ins 6.57, Wis. Adm. Code.

Action—Noncompliance, see comments in Summary of Current Examination Results.

5. Holding Company—It is recommended that the company prepare the annual statement's holding company organizational chart to accurately reflect all affiliates, their legal names, and their relationship to one another.

Action—Compliance.

6. Holding Company—It is recommended that future holding company registration statements be completed in accordance with s. Ins 40.03, Wis. Adm. Code. In so doing, particular attention should be paid to making the required disclosures of the agreements, commitments, and loans that exist among members of the holding company system.

Action—Compliance.

7. Interest and Investment Income Due and Accrued—It is recommended that the company properly calculate the accrued interest to be included on the annual statement.

Action—Compliance.

8. Receivable from Parent—It is recommended that the plan take steps to promptly settle that portion of the receivable from Vision Service Plan representing the \$300,000 related to the canceled repayment of the subordinated debt.

Action—Compliance.

9. Surplus Notes Repayment—It is recommended that the company clearly identify surplus note repayments in the Underwriting and Investment Exhibit of the annual statement.

Action—Compliance.

Summary of Current Examination Results

Management and Control

Article IV, section 1, of the articles of incorporation and article V, section 1, of the bylaws provide that directors will have terms of three years duration. During the last examination it was discovered that the company was electing directors to serve a one-year term without regard to its articles of incorporation and bylaws. During the current examination period the company was again not electing its directors in compliance with its articles of incorporation and bylaws. On April 30, 1998, the directors were elected to the board for a term ending May 27, 2000. This was not a three-year term. Then on November 6, 2000, the directors were elected to serve until November 2003. At this point the directors were elected to serve a three-year term. However, on July 22, 2002, three of the directors were again elected to serve until the next annual meeting. It is again recommended that the company either observe the requirements of article IV, section 1, of its articles of incorporation, and article V, section 1, of the bylaws, concerning the duration of director terms, or amend these provisions to reflect intended practices.

Biographical Data

Section Ins 6.52, Wis. Adm. Code, requires that companies file a biographical report on any new director or officer within 15 days of their election or appointment. The compliance examination as of December 31, 1991, and December 31, 1996 noted that such reports had not been supplied for all officers and directors then in office. Biographicals for the current examination were not filed for Catherine Amos and Julie Edwards. It is again recommended that the company report biographical data relating to company officers and directors in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

Invested Assets

The company has entered into a sweep agreement and holds its investments with Bank of America. In addition, the Bank of America holds the company's bonds in safekeeping. As part of the examination process, copies of the custodial and sweep agreement were requested. The custodial agreement did not include signatures and did not specifically state it was between the bank and WVSP. The indemnification clause also read that the bank would

indemnify the company for loss or securities occasioned by the gross negligence or dishonesty of the bank's officers, etc. The NAIC Financial Examiner's handbook is specific in saying that indemnification of the bank or trust company shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the bank or trust company. Therefore, the proper indemnification is not being provided since the term gross negligence is used.

In addition the Sweep Agreement was reviewed for the proper indemnification clause.

In this case, the bank notes their limitation in liability under the agreement as follows:

- Bank will not be liable for any damages arising out of or relating to its performance under the Agreement other than those money damages actually incurred by Customer¹ which result directly from Bank's failure to exercise reasonable care.
- In no event, will bank be liable for any special, indirect, exemplary or consequential damages, including but not limited to lost profits or customer tax penalties.
- Bank will not be responsible for acts or omissions of company's officers or the acts or omissions of any other person or entity, including but not limited to any clearing house association or processor, any funds transfer system and Federal Reserve Bank, any other financial Institution or any supplier, and no such person or entity will be deemed Bank's agent.
- Bank will not be liable for and will be excused from any failure or delay in performing its obligations under the Agreement if (i) such failure or delay is caused by circumstances beyond Bank's reasonable control including any natural disaster, emergency conditions (such as war, riot, theft or labor dispute), legal constraint or governmental action or inaction violated any law guideline, rule or any governmental authority. No such failure or delay will constitute a breach of agreement.
- Protection from third parties: Customer shall indemnify bank against and hold it harmless from any and all liabilities, claims, costs, expenses etc. arising out of or relating to disputes or legal actions by parties other than the customer and the bank concerning the service. This section does not apply to any such liabilities, claims, costs, expenses or damages attributable to the gross negligence or intentional misconduct of bank.

In this case the bank is not indemnifying the WVSP for any such loss was caused by the negligence or dishonesty of the bank or trust company. Also, the bank uses a servicing agent to distribute shares of the Funds. No indemnification is provided for use of this agent. The contract should note the bank responsible for the acts of its officers, employees, agents, and sub-custodians. It is recommended the company enter into a custodial and sweep agreement with its

¹ Customer in this case refers to Wisconsin Vision Service Plan

bank that contains the proper indemnification provisions as contained in the NAIC Financial Examiner's Handbook.

As noted above, the company has entered into a sweep agreement with its bank. Each day an amount of money is swept into the InvestAccount and invested in the Nation's Cash Reserve money market fund. This money market fund is listed as a Class One Market Fund in the Purposes and Procedures Manual of NAIC Securities Valuation Office. The NAIC Annual Statement for Health Insurers note that class one money market funds should be reported in Schedule DA of the annual statement. The amount in the money market fund at year-end was listed on Schedule E of the annual statement. Due to the materiality of the balance the examination reclassified \$1,379,954 from cash to short term investments.

The investment in the money market fund as of December 31, 2001, had a value of \$1,379,954 and, for compulsory surplus purposes, it exceeded the class limitation for investments in assets of a single issuer and its affiliates (10% of assets) prescribed in s. 620.23 (2) (b), Wis. Stat. Pursuant to s. 620.22 (9), Wis. Stat. (the "basket" clause), the company may include investments not specifically prohibited by statute, to the extent of not more than 5% of the first \$500,000,000 of the insurer's assets plus 10% of the insurer's assets exceeding \$500,000,000 for compulsory and security surplus calculations. Section 620.21, Wis. Stat., states that the amount of the investment exceeding the limitations cannot be counted toward satisfying the compulsory and security surplus requirement. Therefore, the amount of the investment in excess of 15% of assets (the 10% limitation plus the 5% "basket" clause) should be deducted from the insurer's assets when calculating compulsory surplus. WVSP does not calculate compulsory and security surplus, but has a minimum surplus order. The amount in excess of the 15% limitation of assets will be deducted from the company's surplus and then compared to see if the company still meets the surplus order. As December 31, 2001, the company's surplus adjusted for the 15% limitation exceeded the amount needed per the surplus order. It is recommended that the company monitor its investments with respect to the investment limitations to ensure the company meets the compulsory surplus order.

Affiliated Agreements

WVSP entered into an agreement for Vision Service Plan to provide administrative and marketing services. The agreement does not contain standards of performance and there is no indemnification clause. According to the terms of the agreement, VSP is “deemed to be an independent contractor and shall not be responsible for any negligent, inappropriate, dishonest or illegal acts committed by WIVSP² or its officers.” Section 617.21, Wis. Stat., requires transactions between an insurer and its affiliates to be reasonable and fair to the interests of the insurer. It is questionable whether this particular agreement is fair to the interests of WVSP since the agreement has no indemnification clause and includes no standards for performance. It is recommended that, pursuant to s. 617.21, Wis. Stat., the company amend the Administration and Marketing agreement with VSP.

In addition, the agreement discloses that VSP and WVSP agree that their respective panels of doctors shall provide vision care services and materials to patients covered under the other party’s plan, and also to patients covered by other vision care plans licensed by VSP. The company purports that there is no longer a need to have reciprocal arrangements with other vision service plans. This was in place before VSP controlled all other vision plans in the holding company group. Now, all claims are processed by VSP and charged to the company based on whose member it is. The agreement should reflect the current practices of the company. It is recommended the company amend its Administration and Marketing Agreement to reflect the current practices of the company.

Reinsurance

The examination disclosed that the company has a reinsurance contract with United Wisconsin Life Insurance Company (UWLIC). Under this agreement the company is assuming the vision risks associated with certain plans underwritten by UWLIC. The company did not recognize this agreement as a reinsurance agreement and did not report it in Schedule S of its annual statement. This also led to errors in the company’s Underwriting and Investment Exhibit Part 1, Exhibit 2, the Exhibit of Premiums, Enrollment and Utilization and Schedule T because the amount

² Wisconsin Vision Service Plan (WVSP) is referred to as WIVSP in the agreement

of premium and enrollment was being reported as direct business. It is recommended the company recognize its arrangement with United Wisconsin Life Insurance Company as reinsurance and properly report its direct premium, assumed premium and enrollment on the annual statement schedules described above pursuant to the NAIC Annual Statement Instructions for Health Insurers.

Agents

The previous examination report contained a recommendation requiring the company to properly list all of its agents with the OCI. This examination disclosed that the company was unable to produce a listing of agents for comparison to those agents it listed with the OCI. The company was able to provide a list of agencies. However, a comparison of agents to agencies only provided that four of the 175 agents listed with the OCI were on the company's list. The company is aware of the problem and stated that it would work with the OCI to resolve the problem. It is again recommended that the company report its agent appointments to OCI pursuant to s. 628.11, Wis. Stat., and s. Ins 6.57, Wis. Adm. Code.

VII. CONCLUSION

Wisconsin Vision Service Plan's 2001 annual statement reported assets of \$3,498,235, liabilities of \$1,383,485 and surplus of \$2,114,750. Operations for 2001 produced a net loss, after federal and foreign income taxes, of \$358,493 on revenues of \$5.6 million.

The accrual of \$510,000 for federal and foreign income taxes decreased the company's net income. This liability was established pending the outcome of the Internal Revenue Services (IRS) tax audit. The IRS is contesting that the company is a taxable entity based on issues raised regarding unrelated business income. The company's parent, Vision Service Plan was formally notified on October 22, 2002 that the IRS had revoked its tax-exempt status, effective prospectively only as of the tax year beginning January 1, 2003. During 2003, the IRS is expected to prospectively revoke the tax-exempt status of the remaining exempt affiliates including the company. The company will continue to vigorously defend its tax-exempt status.

The company complied with only five of the nine recommendations contained in the prior examination report. The current examination resulted in one reclassification of \$1.4 million, consisting of a reclassification of a money market fund from cash to short term investments. The examination resulted in eight recommendations as summarized on the following page.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 19 - Management and Control—It is again recommended that the company either observe the requirements of article IV, section 1, of its articles of incorporation, and article V, section 1, of the bylaws, concerning the duration of director terms, or amend these provisions to reflect intended practices.
2. Page 19 - Biographical Data—It is again recommended that the company report biographical data relating to company officers and directors in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.
3. Page 20 - Invested Assets—It is recommended the company enter into a custodial and sweep agreement with its bank that contains the proper indemnification provisions as contained in the NAIC Financial Examiner's Handbook.
4. Page 21 - Invested Assets—It is recommended that the company monitor its investments with respect to the investment limitations to ensure the company meets the compulsory surplus order.
5. Page 22 - Affiliated Agreements—It is recommended that, pursuant to s. 617.21, Wis. Stat., the company amend the Administration and Marketing agreement with VSP.
6. Page 22 - Affiliated Agreements—It is recommended the company amend its Administration and Marketing Agreement to reflect the current practices of the company.
7. Page 23 - Reinsurance—It is recommended the company recognize its arrangement with United Wisconsin Life Insurance Company as reinsurance and properly report its direct premium, assumed premium and enrollment on the annual statement schedules described above pursuant to the NAIC Annual Statement Instructions for Health Insurers.
8. Page 23 - Agents— It is again recommended that the company report its agent appointments to OCI pursuant to s. 628.11, Wis. Stat., and s. Ins 6.57, Wis. Adm. Code.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Sarah M. Haeft	Insurance Financial Examiner
Randy Milquet	Insurance Financial Examiner - Advanced

Respectfully submitted,

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Examiner-in-Charge